Using Housing Wealth to Facilitate Asset Division in "Silver Divorce"

3 Scenarios Show How Reverse Mortgages Can Simplify Divorce for Seniors

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In a remarkable contrast to other age cohorts whose divorce rates are decreasing, the divorce rate among older Americans is actually increasing.

A study prepared by academic sociologists Susan I. Brown and I-Fen Lin and reported in the *Washington Post* states that "Since 1990, the divorce rate for Americans over the age of 50 has doubled, and more than doubled for those over age 65." The report goes on to note that "At a time when divorce rates for other age groups have stabilized or dropped, fully one out of four people experiencing divorce in the United States is 50 or older, and nearly one in 10 is 65 or older. . . "

ASSESS "SILVER" ASSETS

Having an understanding of two important economic concerns for divorcing couples in the 50-and-over demographic, known as "Silver Divorce," will help financial planners better advise clients:

Accumulated Wealth. By age 50 (and even more so by age 65), many people have accumulated some wealth, primarily a home and some retirement savings (e.g., 401(k) accounts or rollover IRAs). Therefore, in Silver Divorce, the division of these assets often has greater significance than in the divorces of younger couples.

Retirement Income. By age 50 (and even more so by age 65), people are approaching or have reached retirement. Therefore, in Silver Divorce, retirement income often has greater significance than in the divorces of younger couples.

THE RELEVANCE OF REVERSE MORTGAGES

Reverse mortgages (a.k.a. Home Equity Conversion Mortgages (HECMs)) can play a very important role in meeting the economic concerns of retirement-aged couples who are divorcing, both to facilitate the division of a couple's major assets and to optimize the assets that can be used for retirement income.

To better illustrate how reverse mortgages work in the context of Silver Divorce, we've provided three examples for you to follow.

5 Reverse Mortgage Facts to Keep in Mind

Most people, including financial planners and others providing services in divorce matters, have a limited understanding of reverse mortgages. These five points help clarify what reverse mortgages are and how they work:

1 A reverse mortgage is simply a loan secured on the borrower's principal residence, with required repayment deferred until the borrower permanently leaves the residence;

2 The loan proceeds can be taken as a lump sum, a line of credit, in an annuitized form, a lifetime or term of monthly payments, or any combination of these forms;

3 The loan is available only to borrowers age 62 or older;

4 The loan can be taken on a home currently owned by the borrower or for purchasing a new home; and

5 The home value taken into account in determining the loan amount available is the lesser of the appraised value or $636,150; typically the loan-to-value ratio is in the range of 50% to 60% (depending on the borrower's age).

EXAMPLE 1: BUYOUT SCENARIO WITH NO EXISTING MORTGAGE

The first example is a rather simple scenario:

a. Joe and Laura, who are both in their mid-70s, are divorcing. Their most significant asset is their home, which they own free and clear of debt and which is community property. The couple also owns a classic automobile, which Joe has restored.

- Home value is $800,000.
- Automobile value is $50,000.
- They agree that Laura will keep the home, Joe will keep the automobile, and Joe's interest in the community assets will be bought out for $425,000.

b. Initial Steps:

- Laura obtains a HECM in the amount of $375,000.
- This amount of cash, plus the automobile, aggregating $425,000 in value, is transferred to Joe.

c. Subsequent Steps:

- Joe purchases a new home for $700,000.
- He uses the $375,000 he has received in the divorce settlement as a down payment, and obtains a HECM. The HECM allows him to borrow $375,000. Of that amount, he uses $325,000 to complete the payment for the new home, and retains another $50,000 as a line of credit for any future use.

d. Results for Both Parties:

- Both parties remain homeowners, not renters
- Neither party incurs any monthly mortgage payment obligations.
- No capital gain tax or sale fees were incurred.

EXAMPLE 2:
ASSET DIVISION SCENARIO (WITH EXISTING MORTGAGE)

The second example begins with a slightly more complicated scenario:

a. Bill and Betty, who are both in their late 60s, are divorcing. Their most significant asset is their home, which is community property. Now that their children are grown and on their own, the home is much bigger than Bill and Betty need. Moreover, because they re-financed the home several years ago, there is still a substantial mortgage debt against it. The monthly payments on the mortgage are a heavy burden on Bill and Betty's finances.

- Home Value is $1,650,000, subject to a mortgage of $600,000.
- They agree to sell the home, using the proceeds to pay off the mortgage debt, the sales fees and the capital gain taxes, and to divide the net proceeds equally.

b. Initial Steps:

• Sell existing home, receive	$1,650,000
• Pay off mortgage	(600,000)
• Pay sales fees	(95,000)
• Pay capital gain tax	(155,000)
Net Proceeds	$800,000

c. Subsequent Steps:

- Equally divide the net proceeds: Each party receives $400,000.
- Each party purchases a new home, using $400,000 as down payment, and uses a HECM (of up to $350,000) for the remainder of the purchase price.

d. Results for Both Parties:

- Both parties become homeowners again, not renters.
- Neither party incurs any monthly mortgage payment obligations.
- Both parties participate equally in sale fees and capital gain taxes.

"The divorce rate among older Americans is actually increasing."

EXAMPLE 3:
ASSET DIVISION SCENARIO (WITH SMALLER EXISTING MORTGAGE)

The third example is essentially the same as the previous example, except that the existing mortgage is a great deal smaller. The result sheds light on the other important aspect of Silver Divorce: money invested to generate retirement income.

a. The example of Bill and Betty is repeated, but instead of their existing mortgage being $600,000, it is assumed to be "only" $300,000. Although less than $600,000, the monthly mortgage payments nonetheless impose a heavy burden on their finances.

b. Initial Steps:

- Proceeding through the same initial steps as in the previous example, but with a $300,000 existing mortgage instead of a $600,000 existing mortgage, results in net proceeds that are $300,000 higher, i.e. $1,100,000 instead of $800,000.

c. Subsequent Steps:

- Proceeding through the same subsequent steps as in the previous example, the parties each receive $550,000. They each purchase a new home as in the previous example, but unlike in the previous example, they each also have $150,000 to invest in assets that will provide retirement income for them.

d. Results for Both Parties:

- The parties have the same results as in the previous example, but in addition, they each have $150,000 to invest in assets that will provide retirement income.

WHAT ABOUT SITUATIONS INVOLVING HIGHER VALUE HOMES?

Key distinction: As we noted above, the maximum home value that can be taken into account for HECMs is currently $636,150. This does not mean that a higher value home cannot be used to obtain a HECM; it simply means that only the first $636,150 of its value can be considered.

"JUMBO" MORTGAGES: BIGGER DOESN'T ALWAYS MEAN BETTER

Although most reverse mortgages are HECMs, so-called "jumbo" reverse mortgages are also currently available—and may be a viable option for clients. Jumbo reverse mortgages make available much larger amounts, up to $1 million and above. However, these jumbo reverse mortgages are much less flexible than HECMs, and also much more costly in terms of interest rates.

The lack of flexibility, in particular, means that the jumbo reverse mortgage loans require that the entire loan amount be taken at the outset in a lump sum; the loan cannot be taken in the other forms available with HECMs, such as a credit line or a lifetime annuity.

Another downside: The loan-to-value ratios of jumbo reverse mortgages are generally much lower than the loan-to-value ratios of HECMs (largely because the lenders of HECMs are insured by the FHA against loss). While loan-to-value ratios of HECMs can equal or exceed 50% (depending upon the age of the borrower when the loan is established), the loan-to-value ratios of jumbo reverse mortgages generally do not exceed 40%.

APPLYING "JUMBOS" TO THE SCENARIOS

Referring back to the three examples, it is clear that the first example cannot be scaled up. Suppose that the home value is $1.8 million instead of $800,000. Then Laura would need a jumbo reverse mortgage in the amount of $875,000, plus the automobile, in order to buy out Joe's interest in the community assets. That amount represents a loan-to-value ratio of approximately 49% of the home's value, well above the maximum of 40% that might actually be obtained from a jumbo reverse mortgage.

On the other hand, consider the third example, with the added features that there is a $2 million 401(k) account which is divided pursuant to a QDRO, and that Betty keeps the home.

The couple could then agree that Betty obtains a jumbo reverse mortgage in the amount of $650,000, which reflects a 39% loan-to-value ratio. She then uses $300,000 of that amount to pay off the existing conventional mortgage and transfers the remaining $350,000 to Bill.

To complete the division of community assets, the QDRO provides that the 401(k) account is divided so that Bill retains $1,325,000, and Betty retains $675,000. She can invest the $675,000 to provide income, and will not have to use any income to make mortgage payments.

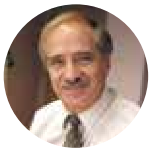
SUMMING UP

For clients approaching retirement and whose accumulated wealth is in the form of a home and retirement assets such as 401(k) accounts or IRAs, a reverse mortgage can be extremely useful to facilitate asset division.

Professionals who provide services to divorcing couples, such as financial planners, may find other potential uses of the reverse mortgage model to better serve divorcing couples, particularly those in the Silver Divorce age bracket.

For more information on Silver Divorce: See Brigid Schulte's article "Till Death Do Us Part? No Way. Gray Divorce on the Rise," *Washington Post*, October 8, 2014, (reporting on a study prepared by Susan I. Brown and I-Fen Lin, sociologists at Bowling Green State University) and Rodney Brooks' article "Put in the Red by 'Gray Divorce,'" *Washington Post*, April 10, 2016.

For more information on reverse mortgages: See "What's the Deal with Reverse Mortgages?" by Shelley Giordano, published by People Tested Media, 2015. See also "Reverse Mortgages – How to Use Reverse Mortgages to Secure Your Retirement" by Wade Pfau, published by Retirement Researcher Media. ◆



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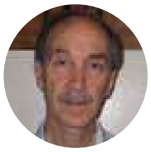

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